

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 99-0140 FIT
Financial Institutions Tax
For Tax Periods: 1994 through 1996

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ISSUES

I. Financial Institutions Tax — “Add back” of State and Local Taxes

Authority: IC 6-5.5-1-18, IC 6-5.5-5-1(b);
45 IAC 17-2-1, 45 IAC 17-3-2, 45 IAC 17-3-5

Taxpayer protests proposed assessments of Indiana's Financial Institutions Tax.

STATEMENT OF FACTS

Taxpayer is a wholly owned subsidiary of a Delaware corporation (“Taxpayer's Parent”). Taxpayer's Parent and Subsidiaries (including taxpayer) file a consolidated return for federal income tax purposes. Taxpayer's Parent and other Subsidiaries also file a consolidated return for Indiana adjusted gross income tax purposes. Taxpayer has several wholly owned subsidiaries with which it files a combined Indiana Financial Institution Tax return.

The Indiana Department of Revenue (“Department”) audited taxpayer for tax years 1994 through 1996. The audit resulted in additional proposed assessments of Indiana Financial Institution Tax (“FIT”). These assessments were based on taxpayer's failure to add back—to its Indiana tax base—certain expenses deducted from federal adjusted gross income. Taxpayer now protests these assessments.

I. Financial Institutions Tax — “Add back” of State and Local Taxes

DISCUSSION

Taxpayer and Taxpayer Subsidiaries filed a combined FIT return with the state of Indiana for tax periods covering years 1994 through 1996. In order to compute its Indiana FIT liabilities,

Taxpayer prepared (and submitted) federal pro forma returns. Audit explains the relationship between the *filed* Indiana FIT return and the *prepared* federal pro forma returns:

The [Indiana] FIT return line 1...[represents the] Federal taxable income [taken] from the [federal] pro forma returns. *The taxpayer's calculation of federal taxable income includes a deduction from gross income for income tax expenses which were included in the "other deductions" total of the pro forma return, therefore the taxpayer has taken a deduction for income tax when starting the Indiana tax returns (emphasis added).*

Taxpayer's federal pro forma returns, according to Audit, indicate that taxpayer deducted from its federal gross income expenses representing payments of state and local taxes. Taxpayer, however, in contravention of IC 6-5.5-1-2(a)(1)(C), failed to "add back" these deducted amounts in computing its Indiana FIT liabilities. Consequently, Audit proposed additional assessments of Indiana FIT.

Taxpayer contends the expenses at issue (and, of course, the related deductions), do not represent the payment of taxes *levied* by a state. Specifically, according to taxpayer, these taxes were neither levied upon nor paid by *this particular taxpayer*. Taxpayer explains:

[Taxpayer's Parent], Taxpayer, and the Taxpayer Subsidiaries are parties to a certain Tax Allocation Agreement (the "Agreement"). [Taxpayer's Parent] files consolidated and/or combined income tax returns in many states. The consolidated and/or combined state income tax returns filed by [Taxpayer's Parent] in some cases include the income of Taxpayer and the Taxpayer Subsidiaries. In those cases, the applicable state income tax for the consolidated/combined group is levied by the states upon [Taxpayer's Parent], who must pay the state income tax for the group.

Under the Agreement..., the Taxpayer Subsidiaries each pay to Taxpayer a management fee representing the amount each Taxpayer Subsidiary would otherwise be required to pay (but is not required by state law to pay) AS IF it were a stand-alone state taxpayer and not part of the consolidated and/or combined state returns filed by [Taxpayer's Parent]. Taxpayer collects these management fees from the Taxpayer Subsidiaries, and then remits them to [Taxpayer's Parent].

Additionally, taxpayer has argued that the payments Audit seeks to addback do not represent taxes based on or measured by income, but rather represent "a management fee charged by [Taxpayer's Parent] which is deductible as an ordinary and necessary business expense under Section 162 of the IRC.

Notwithstanding taxpayer's arguments to the contrary, taxpayer may not avoid the prescriptions of IC 6-5.5-1-2(a)(1)(C) by attempting to re-characterize "taxes based on or measured by income and levied at the state level" as management fees paid to its parent. That Taxpayer's Parent

chose to file combined and/or consolidated returns that included income from Taxpayer and Taxpayer Subsidiaries does not change the source of the income earned or the allocation of taxes paid. In this instance, Audit has relied on taxpayer's own pro forma returns to identify those taxes deducted from taxpayer's federal taxable income. Absent a showing that these state and local taxes were neither paid nor deducted by the filing entity, Audit's reliance on taxpayer's pro forma return was proper.

FINDING

Taxpayer's protest is denied.